Monthly Economic Monitor Ukraine

- Ruling coalition broke up after pro-presidential faction left it, protesting against the adoption of laws that dilute the powers of the President.
- Between January and August, real GDP growth jumped to 7.1% yoy as good crop harvest boosted agriculture.
- The Law on Joint Stock Companies was adopted by the Verkhovna Rada, but still not signed by the President.
- Current account deficit is estimated at USD 7.5 bn in the first eight months of 2008.
- Draft State Budget for 2009 envisages further increases in wages and pensions.
- Consumer price inflation slowed to 24.6% yoy in September.
- Fitch rating agency downgraded rating outlook for nine large Ukrainian banks.

No.10 (96)
October
2008

Population: 46.4 m
Industry/GDP: 32%
Agriculture/GDP: 7%
Investment/GDP: 27%
Exports to: Russia 26%, EU 28%
Imports from: Russia 28%, EU 37%

Politics: The breakup of the ruling coalition

On September 16, Speaker of the Verkhovna Rada Arseniy Yatsenyuk formally announced dissolution of the parliamentary coalition formed by the BYUT faction led by the Prime Minister Yulia Tymoshenko and the pro-presidential "Our Ukraine" block. The latter left the coalition after BYUT and opposition parties voted to support a number of laws diluting the President's authority. According to the Constitution, members of the Parliament have thirty days to form a new ruling coalition. Otherwise, the President has the right to dissolve the Parliament and call snap elections.

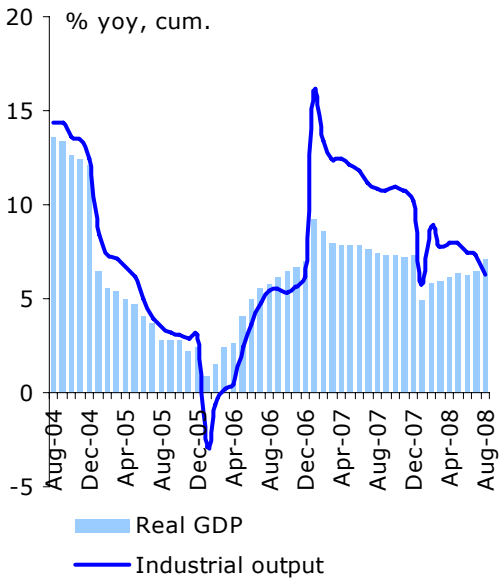
As no new coalition was formed, on October 9 President Victor Yushchenko announced about pre-term parliamentary elections to be held in December.

Real GDP: Agriculture fosters GDP growth in August

Real GDP grew at 7.1% yoy between January and August 2008 as record crops harvest caused value added in agriculture to jump to 24.2% yoy. This acceleration more than compensated sizable slowdown in such sectors as manufacturing and trade. In particular, growth rate in trade decelerated from 11.8% yoy in the first seven months of the year to 10.7% yoy over eight months, largely due to gradual slowing of retail trade. Lower growth rates in manufacturing and trade along with contraction in construction may signify cooling demand in economy.

Industrial output decelerated to 6.3% yoy in eight months of 2008, which is 1.0 percentage points lower than over seven months, due to slowdown in mining, metallurgy and machine building. Falling metal prices and decrease in demand in main export markets may explain this trend. Slowdown in industry is likely to continue in the following months as world economic growth decelerates and global financial crisis deepens.

Real GDP and industrial production



Source: Derzhkomstat

Sectoral trends: Law on Join Stock Companies has been approved by the Parliament

Corporate governance. On September 17, the Verkhovna Rada adopted the "Law On Joint Stock Companies" (JSCs) that has been on the agenda for more than seven years. Current legislation on joint stock companies that produce the lion share of the output in Ukraine has been outdated and contained a number of legal loopholes. The new law should considerably improve protection of the rights of minority shareholders and governance of the JSCs, as well as to close a number of loopholes for legally dubious hostile takeovers. Thus, the new legislation removes one of the largest obstacles to the development of an efficient stock market in Ukraine. The law has yet to be signed by the President to come into force.

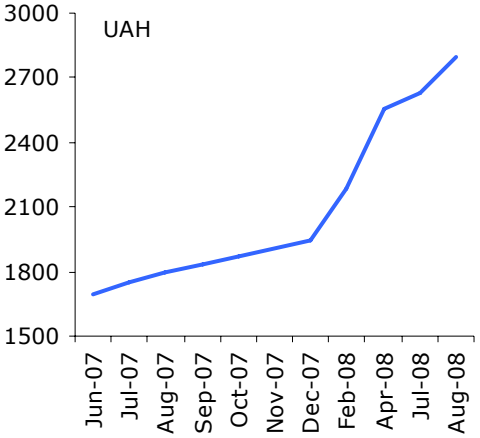
Institute for Economic Research
and Policy Consulting
Reytarska 8/5-A, 01034 Kyiv
Tel. (+38044) 278-6342
Fax (+38044) 278-6336
E-mail: institute@ier.kiev.ua
http://www.ier.kiev.ua

Energy. On September 25, the Parliament passed a law introducing "green tariffs" for so-called alternative electricity and heat producers. According to the law, "green tariffs" will be set by the National Electricity Regulatory Commission for the following 10 years, and will be at least twice the cost of electricity to the wholesale market for the year preceding the tariff decision. The law will support mainly wind power producers and small-scale hydropower projects as large OJSC "Ukrhydroenergo" units are excluded from the list of beneficiaries.

Transport. In September the Ministry of Transportation introduced temporary 9-10% discounts for transportation of coke, iron ore, and limestone responding to the pressure of metal-producing enterprises, *de-facto* canceling for one specific industry the impact of August decision to increase all freight rail tariffs by 6.5%. The step could be treated as indirect subsidy to metal producers, which is against Ukraine's WTO commitments. Moreover, it once again showed lack of transparency in setting of transport tariffs and urgent necessity to establish an independent regulator.

Telecommunications. The members of the National Commission for Regulation of Communications (NCRC) assigned by the Government took up their duties in September, as the President cancelled his June Decree suspending the NCRC members appointment. However, it is likely to be a short-term compromise necessary to conduct tender for lucrative 3G licenses. Existing inconsistencies in legislation could result in further struggles for control over communications regulator until the legal controversies are settled.

Freight railway tranportation tariffs*



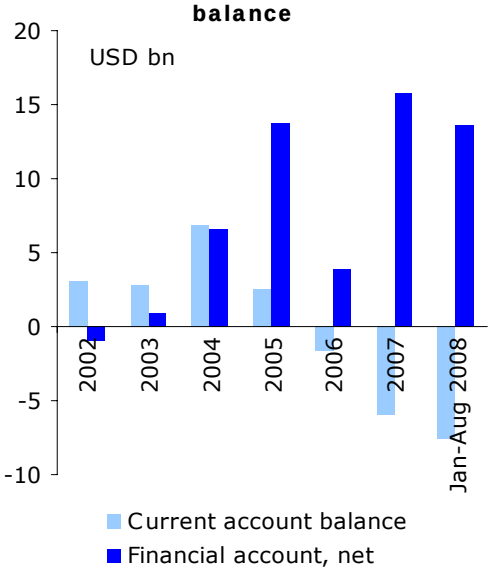
Source: Ministry of Transport and Communications
* distance ~ 500 km, weight = 80 tonnes, tariff scheme 1

External sector: Current account deficit reached USD 7.5 bn between January and August 2008

According to the NBU preliminary estimates between January and August current account deficit widened to USD 7.5 bn or 6% of GDP. Merchandise export and import growth slowed to 48.5% yoy and 56.2% yoy in dollar terms, respectively. The deceleration of exports was driven mainly by decline in steel prices that dropped the most in North America and Asia, destinations which are responsible for half of Ukrainian steel exports. Lower oil prices and cooling domestic demand could explain slowdown in imports.

In August capital inflows into Ukraine continued, and the eight-month financial account surplus reached USD 13.7 bn. Strong growth continued in FDI inflows that increased by 21.4% yoy to USD 8.1 bn, and in long-term financing for the banking sector that grew by 26.2% yoy. However, the new wave of the global financial crisis caused record outflow of portfolio investments from emerging markets and from Ukraine in particular during September, pointing to the high risk of the significant deterioration of financial account towards the end of 2008.

Current and financial accounts balance



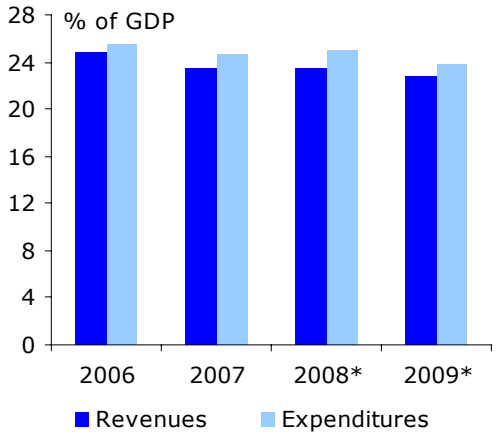
Source: NBU

Fiscal policy: Government submitted the Draft State Budget for 2009 to the Verkhovna Rada

On September 15, the Government submitted the Draft State Budget for 2009 to the Parliament. The central fiscal revenues are foreseen at UAH 288.1 bn (22.7% of GDP) with expenditures of UAH 302.2 bn (23.8% of GDP) and central fiscal deficit at 1.4% of GDP. The draft budget law is grounded on unchanged tax legislation. Among key features of the budget are the improvement in the funding of the local authorities, and the sharp increase in state guarantees that would drive the state guaranteed debt up by over 3% of GDP. On the expenditure side, both social and capital spending continue growing, though the share of capital expenditures is expected to increase due to preparations for the European Football Championship in 2012.

In September, the Verkhovna Rada continued to change the 2008 State Budget in the number of minor amendments. The central fiscal revenues plan was increased by UAH 3.9 bn (to UAH 224.7 bn) thanks to higher receipts of VAT on imports. The additional funds are to be used to support agriculture (UAH 1.8 bn) and state coalmines

Central Budget

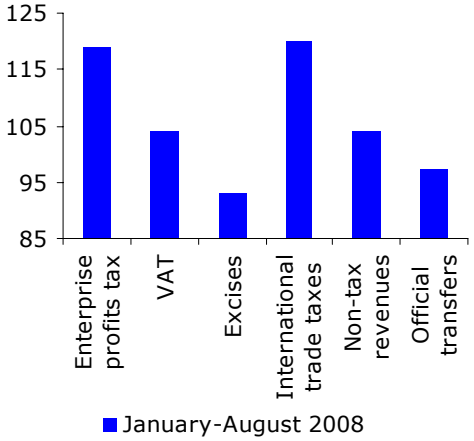


* planned indicators
Sources: State Treasury, Budget Law 2008 with amendments, Draft Budget Law 2009

(UAH 0.6 bn in funding and UAH 3.1 bn as state guarantees), to pay increased wages to public sector employees (UAH 1.1 bn), and to increase sports spending (UAH 0.4 bn).

Between January and August 2008, the central fiscal revenues were executed at 107.1% of the target. As it is usual in 2008 the over-execution has been attributed to higher than planned receipts from enterprise profit tax and VAT (by 19.0% and 4.2%, respectively). The execution of central fiscal expenditures continued to improve gradually to 96.2% of the target. As a result, central fiscal surplus (general fund) reached UAH 2.3 bn or 0.4% of GDP.

Central fiscal revenues execution



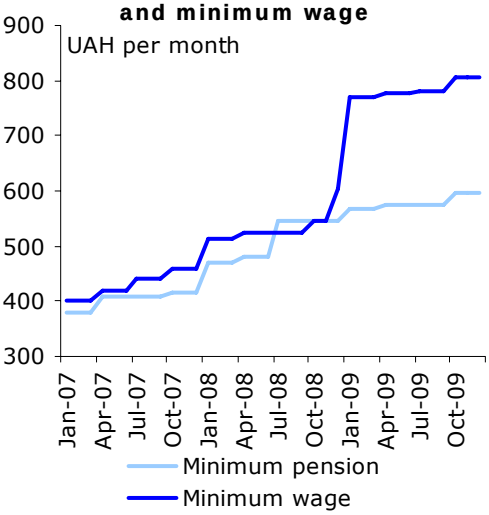
Source: State Treasury reports

Social policy: New stage of pension increases in 2009

The Draft State Budget Law for 2009 foresees the minimum wage at the subsistence minimum for able working individuals. Thus, it will be UAH 770 from January and will rise gradually to reach UAH 807 in October. However, wages in public sector will be temporarily set as multiples of UAH 630 in January instead of minimum wage due to the lack of fiscal funds. The disparity is to be eliminated in December.

The minimum pension will increase from UAH 568 in January 2009 to UAH 596 in October. The central fiscal transfer to the Pension Fund is envisaged at UAH 44.4 bn or 14.7% of central fiscal expenditures, out of which UAH 7.6 bn will be used to pay increased pensions to miners. The total expenditures of the Pension Fund are expected at UAH 194.5 bn or 15.3% of GDP. Extremely high level of expenditures in pay-as-you-go pension system makes it unsustainable in the long run and enormously complicates pension reform.

Monthly minimum pension and minimum wage



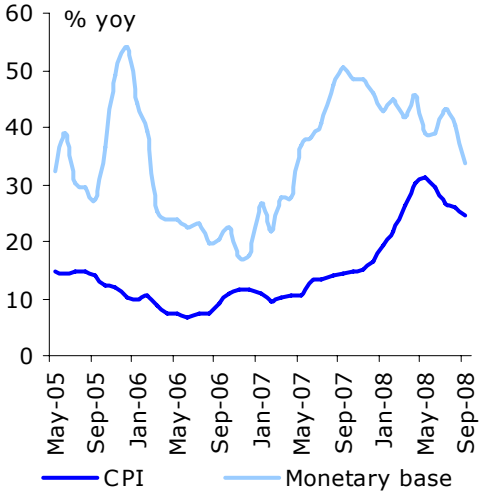
Source: State Budget Laws for 2006, 2007 and 2008

Monetary policy: Inflation decelerated to 24.6% yoy

In September consumer inflation decelerated to 24.6% yoy. Good harvest constrained growth in food prices, while statistical base effect caused further deceleration in consumer price index growth. However, September round of wage and pension increases resulted in additional demand-side pressure on inflation limiting its deceleration.

Monetary aggregate growth decelerated sharply in September as monetary base decelerated to 33.8% yoy and money supply to 40.2%. Liquidity in September remained limited and interbank interest rates were high as commercial banks hoarded cash under increased uncertainty in global financial crisis. Reacting to the possible funding problems, the NBU repealed upper bounds for interest rates on long-term foreign loans starting from October 27. Increased external funding after capital controls relaxation may be mixed blessing for Ukrainian banks as it will be high-cost.

CPI and monetary base development



Source: Derzhkomstat, NBU

Financial markets: Gathering clouds for Ukrainian banks

Banking sector. On September 25, Fitch rating agency downgraded outlook for long-term ratings to negative of nine large Ukrainian banks, including UkrSibbank, Ukrsotsbank, Ukreksimbank and Oschadbank after it downgraded rating for Ukraine. According to Fitch, these banks face liquidity and funding problems. The NBU refuted Fitch statements and warned that it may sue the rating agency.

Another large bank, Prominvestbank (PIB) suffered a run for deposits after rumours about financial difficulties became widespread. Depositors withdraw up to UAH 300 m over the week. As of July 1 PIB had UAH 11.8 bn of household deposits, while Deposit Guarantee Fund has only UAH 1.7 bn in assets. According to the law, if the fund lacks assets to repay the deposits up to the limit set, the state will have to support the Fund with loans. The NBU stated that the PIB is well capitalised and profitable. To quell rumours, the NBU provided UAH 5 bn in liquidity to the PIB. However later NBU introduced temporary administration in PIB and froze deposit withdrawals as PIB didn't provide assets to secure UAH 5 bn loan. According to the PIB the rumours were planted to decrease share price and conduct hostile takeover. So far, the problem seems to be limited to one bank and has not spread to others.

Economic Trends		Q2 07	Q3 07	Q4 07	Q1 08	Q2 08	Q3 08	May	Jun	Jul	Aug	Sep
GDP growth (real)	% yoy	8.6	6.2	7.4	6.5	…	…	7.2	5.4	7.3	10.9	…
GDP growth (real)	% yoy cum.	7.9	7.3	7.6	6.5	…	…	6.4	6.3	6.5	7.1	…
Industrial production (real)	% yoy cum.	11.8	10.7	10.2	7.8	7.5	…	8.0	7.5	7.3	6.3	…
Agricultural production (real)	% yoy cum.	6.3	-5.1	-5.6	0.2	-0.3	…	0.2	-0.3	10.9	21.0	…
CPI	% yoy eop	13	14.4	16.6	26.2	29.3	24.6	31.1	29.3	26.8	26.0	24.6
PPI	% yoy eop	20.6	19.6	23.3	31.8	43.7	42.7	39.4	43.7	46.3	46.9	42.7
Exports (USD)***	% yoy cum.	32.4	27.3	27.4	28.5	41.1	…	35.8"	40.7"	46.6"	…	…
Imports (USD)***	% yoy cum.	33.2	31.5	34.8	45.1	52.9	…	52.3"	55.3"	57.5"	…	…
Merchandise trade balance	USD bn cum.	-3.43	-6.12	-10.6	-4.6	-8.6	…	-8.8"	-9.8"	11.1"	…	…
Current account	USD bn cum.	-1.98	-2.47	-5.9	-3.6	-6.8	x	x	x	x	x	x
Current account	% GDP, cum.	-3.4	-2.5	-4.2	-9.6	-7.9	x	x	x	x	x	x
Gross international reserves	USD bn eop	25.9	30.6	32.5	33.2	35.5	37.5	34.4	35.5	37.9	38.1	37.5
Monetary Base	% yoy eop	38.4	50.6	46.0	41.4	38.9	33.0	38.8	38.9	41.6	40.2	33.0
Lending rate on UAH credits **	% pa, aop	13.9	13.7	14.0	14.6	17.2	17.1	17.5	17.3	17.1	17.3	16.8
Exchange rate (interbank)	USD aop	5.02	5.01	5.04	5.03	4.79	4.70	4.74	4.68	4.61	4.62	4.83
Exchange rate (official)	USD aop	5.05	5.05	5.05	5.05	4.96	4.85	4.99	4.85	4.84	4.84	4.85
Exchange rate (official)	EUR aop	6.81	6.93	7.31	7.56	7.75	7.31	7.76	7.45	7.64	7.29	6.99

Sources: Derzhkomstat, Ministry of Finance, NBU, IFS, Reuters, own calculations

" Monthly figures are only for merchandise exports and imports (source: Derzhkomstat)
Quarterly figures are for trade in goods and services (source: NBU)

* Monthly figures do not include the regular quarterly revision of the GDP series

**Weighted average for different maturities (source: NBU)

*** Growth rate in dollar terms

Key Economic Indicators		1999	2000	2001	2002	2003	2004	2005	2006	2007
Nominal GDP	UAH bn	130.4	170.1	204.2	225.8	267.3	345.1	441.5	544.2	712.9
Nominal GDP	USD bn	31.6	31.3	38.0	42.4	50.1	65.0	86.2	107.8	141.2
GDP growth (real)	% yoy	-0.2	5.9	9.2	5.2	9.6	12.1	2.7	7.3	7.6
Industrial production	% yoy	4.0	13.2	14.2	7.0	15.8	12.5	3.1	6.2	10.2
Agricultural production	% yoy	-6.9	9.8	10.2	1.2	-11.0	19.7	-0.1	0.4	-5.2
CPI	% yoy aop	22.7	28.2	12.0	0.8	5.2	9.0	13.5	9.1	16.6
CPI	% yoy eop	19.2	25.8	6.1	-0.6	8.2	12.3	10.3	11.6	12.8
PPI	% yoy aop	31.5	20.9	8.6	3.1	7.6	20.5	16.7	9.6	19.5
PPI	% yoy eop	15.7	20.8	0.9	5.7	11.1	24.1	9.5	14.1	23.3
Exports (gs, USD)	% yoy	-7.9	17.9	9.5	10.7	24.0	42.6	7.5	13.2	27.4
Imports (gs, USD)	% yoy	-19.1	18.9	14.1	4.9	28.7	31.3	20.4	22.0	34.8
Current account	USD bn	0.9 °	1.2 °°	1.4	3.1	2.9	6.9	2.5	-1.6	-5.9
Current account	% GDP	2.9 °	3.8 °°	3.7	7.6	5.9	10.6	2.9	-1.5	-4.2
FDI (net)	USD bn	0.5	0.6	0.8	0.7	1.4	1.7	6.5	5.3	9.2
International reserves	USD bn	1.09	1.48	3.09	4.42	6.94	9.52	19.39	22.26	32.48
Fiscal balance'''	% GDP	-2.1	-0.7	-1.9	0.8	-0.2	-3.0	-1.9	-0.9	-1.1
Total state debt	% GDP eop	61.0	45.3	36.5	33.5	29.0	24.7	17.7	15.0	12.6
External state debt (total)	% GDP eop	49.9	33.0	26.3	24.1	21.4	18.6	13.4	11.7	10.1
Monetary base	% yoy eop	39.3	39.9	37.4	33.6	30.1	34.1	53.9	17.5	46.0
Exchange rate	USD aop	4.13	5.44	5.37	5.33	5.33	5.31	5.12	5.05	5.05
Exchange rate	USD eop	5.07	5.44	5.30	5.33	5.33	5.31	5.05	5.05	5.05
Exchange rate	EUR aop	4.39	5.03	4.81	5.03	6.02	6.62	6.40	6.32	6.92
Exchange rate	EUR eop	5.20	5.10	4.67	5.53	6.66	7.22	5.97	6.65	7.42

SOURCES: Derzhkomstat, NBU, Ministry of Finance, own calculations

''' "Minus" denotes a consolidated fiscal deficit

° The value of goods transferred to Russia according to the inter-governmental agreement reached in May 1997 on the Black Sea Fleet division totaling USD 726 m is not included

°° The value of the aircraft complexes transferred to Russia as repayment of a gas debts according to the inter-governmental agreement reached in October 1999 totaling USD 274 m is not included.

Notes:

avg	average	**ytd**	year-to-date
cum	cumulative	**p.a.**	per annum
mom	month on month change	**eop**	end of the period
qoq	quarter on quarter change	**aop**	average of the period
yoy	year-on-year change	**gs**	goods and services